

TEACHERS' RETIREMENT BOARD  
SUBCOMMITTEE ON CORPORATE GOVERNANCE

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SUBJECT: Financial Market Reform

ITEM NUMBER: 3

ATTACHMENT(S): 1

ACTION: X

DATE OF MEETING: November 6, 2002

INFORMATION: \_\_\_\_\_

PRESENTER(S): Janice Hester Amey

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**Executive Summary**

At the last meeting of the Subcommittee, staff was directed to review the attached matrix and to recommend a prioritization scheme. Staff has completed the review and recommends that the following areas continue to be the priority concerns for CalSTRS:

**A. Director Independence/Disclosure**

- **Audit Committee Independence-Completed Internal**
- **Audit Committee Authority/Responsibility-Completed Internal**
- **Audit Committee Qualifications-Completed Internal**
- **Executive Compensation-Open\***

**B. External Auditor Independence/Disclosure**

- **Limitations on Non-Audit Service-Completed Internal**
- **Rotation of External Audit Firm/Partners-Completed Internal**
- **Cooling-Off Period Regarding Employment-Completed Internal**

**C. Accounting Standards**

- **Review Accounting Standards-Completed Internal**
- **Improve Oversight of Accounting Industry-Completed Internal**
- **Increase disclosure standards of auditor services/revenues-Completed Internal**
- **Increase mandatory liability limits for external audit firms-Open\***
- **Broader disclosure of forward equity contracts-Open\***

The following items may be considered background issues, always part of the framework but not the priority concerns for this effort at this stage:

**D. General Governance**

- **Develop general governance guidelines-Completed Internal**
- **Establish minimum corporate governance standards-Completed Internal**
- **Reform the PSLRA of 1995-Open\***
- **Adopt Investor Protection Principles-Completed Internal**
- **CEO/CFO attestation to financials-Completed Internal**

**E. Deferred Compensation-Defined Contribution Plans**

- **Employee choice on whether to invest in a company's d.c. plan-Open\***
- **Employee choice over form of matching contribution-Completed Internal**
- **Limit employer stock held by employees to 10%-Open\***
- **Reduce/Eliminate restrictions on employee liquidation-Completed Internal**
- **No record keeper transition/blackout period-Completed Internal**
- **Protect retirement security-Open\***

**Recommended Changes To The Matrix**

Staff recommends that the items in the matrix that are colored in blue, be removed from the active part of the matrix and moved to **Completed or Ongoing Status**. **Completed or Ongoing Status** items could be displayed at the back of matrix as a record and viewed by the members each month or maintained in the Investments Office, available for reference as needed. The attempt here is to streamline the matrix and to place the subsets of the larger issues that were identified on the matrix into a more manageable work-plan format. The **Legislative Comments** section is not affected by this recommendation. Continuing activity of staff in the implementation of Sarbanes-Oxley, such as providing public comment in the rulemaking phase, will continue to be reflected on the matrix. These changes are not meant to suggest that all of the legislative items have been completed and that no additional work needs to be completed by staff on these items. The items that are being suggested for **Completed or Ongoing Status** are items that have been completed by staff on the internal level. This will reduce the size of the matrix and keep only those items that are outstanding in the active section of the matrix.

IMPLEMENTATION PLAN REGARDING FINANCIAL MARKET REFORM

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Director Independence/Disclosure</b>					
1) Audit Committee Independence	Amend Financial Responsibility Criteria for Corporate Investments, Section B, 'Board of Directors', by adding 3A: "It is concluded that since the Audit Committee is a subset of the entire Board of Directors, the performance of the Audit Committee is the responsibility of the entire Board of Directors. The Board of Directors must provide active and independent oversight of all of its review committees, such as Audit, Nominating, Compensation, and Governance. All persons who serve on Audit Committees must be unaffiliated, independent directors, whose only material relationship to the company is the directorship. In recognition of the unique expertise and time commitment required for the Audit Committee, CalSTRS supports the view that members of the Audit Committee should receive greater compensation than other Board Committees. The Board of Directors should also consider limiting the term of Audit Committee service, by automatic rotation or other methods."	Proactive communication of CalSTRS' views on the importance of Audit Committee independence  Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII*  Use press, speaking forums  Seek buy-in from other institutional investors  Testimony	CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration	Guidelines amended on 04/03/02; 1,583 "no" votes cast by CalSTRS on ratification of auditors as of FY '02.  Letters sent to oversight bodies on 04/30/02  Letters sent to: SEC, NYSE, NASD, NACD through July '02.  CEO gave speech to California Chamber of Commerce on 04/16/02--matrix highlighted  Institutional investors being contacted. Meeting with CalPERS scheduled for 04/29/02  (Continued on next page)	<b>Federal:</b> 1) <u>Sarbanes-Oxley Act of 2002:</u> Requires that each audit committee member must be a member of the board of directors and considered "independent". <b>Regulatory:</b> 1) <u>Proposed NYSE Guidelines:</u> Requires audit, nominating and compensation committees to consist of solely independent directors.
NASD = National Association of Securities Dealers NYSE = New York Stock Exchange SEC = Securities and Exchange Commission NACD = National Association of Corporate Directors AICPA = American Institute of Certified Public Accountants CII = Council of Institutional Investors		<u>Current Status of Legislation:</u> <b>Federal Legislation:</b> H.R. 3669 (Portman / Cardin): Committee of the Whole House. H.R. 3762 (Boehner-Thomas): Senate Committee on Health, Education, Labor, and Pensions. H.R. 3763 (Oxley): Combined with Sarbanes Proposal, now called Sarbanes-Oxley Act of 2002 S. 1971 (Grassley): Senate Committee on Finance. S. 1992 (Kennedy): Senate Committee on Health, Education, Labor, and Pensions. S. 2004 (Dodd): Senate Committee on Banking, Housing, and Urban Affairs. S. 2460 (Levin): Senate Committee on Banking, Housing, and Urban Affairs. Sarbanes Proposal: Combined with H.R. 3763 now called Sarbanes-Oxley Act of 2002 Sarbanes-Oxley Act of 2002: Public Law 107-204 <u>Senate Finance Committee Pension Legislation</u>			<b>Regulatory:</b> SEC Regulatory Efforts Proposed NYSE Guidelines NASDAQ - National Association of Securities Dealers Automated Quote System
<u>Current Status of Legislation:</u> <b>State Legislation:</b> AB 2970 (Wayne): Chapter 232 SB 1527 (Burton): Failed passage by Legislature					

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
Director Independence/Disclosure					
1) Audit Committee Independence (Cont.)				<p>Contacted State of Florida, NYCERS, NY State, TIAA CREF, and State of Pennsylvania.</p> <p>CalSTRS issued press release; CII highlighted Subcommittee agenda item in April 18th Newsletter</p> <p>CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.</p>	

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Director Independence/Disclosure</b>					
2) Audit Committee Authority/Responsibility	Amend the Financial Responsibility Criteria for Corporate Investments, Section A, 'Auditors' by replacing subheading 1 with: "The Audit Committee has a unique role in the capital markets and the overall governance structure. The Audit Committee shall have at least 3 members and no more than 5. The Audit Committee shall adopt a formal, written charter and provide a report that references the charter and disclosure, in the company's annual report/proxy statement whether the Audit Committee has complied with its charter responsibilities. Any amendments to the Audit Committee charter shall be reported to the shareholders in the annual report/proxy statement. The Audit Committee members must have full access to company financial documents. The Audit Committee shall regularly evaluate the relationship between management and the external and internal auditors. The Audit Committee shall have responsibility and authority to select, retain/replace and evaluate the external auditor, including any issues that may impair the external auditor's independence and direct the scope of the duties to be performed. The Audit Committee and the Board of Directors, as the fiduciary representatives of shareholders, are the ultimate authority to which the external and internal auditors are accountable."	<p>Proactive communication of CalSTRS views on importance of Audit Committee qualifications</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	<p>CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration</p>	<p>Guidelines amended on 04/03/02; 1,583 "no" votes cast by CalSTRS on ratification of auditors as of FY '02</p> <p>Letters sent to oversight bodies on 04/30/02</p> <p>Letters sent to: SEC, NYSE, NACD, NASD through 07/02</p> <p>CEO gave speech to California Chamber of Commerce on 04/16/02--matrix highlighted</p> <p>Institutional investors being contacted. Meeting with CalPERS scheduled for 04/29/02</p> <p>Contacted State of Florida, NYCERS, NY State, TIAA CREF, State of Pennsylvania</p> <p>CalSTRS issued press release; CII highlighted Subcommittee agenda item in April 18th Newsletter</p> <p>(Continued on next page)</p>	<p><b>Federal:</b></p> <p>1) <u>Administration Proposal</u>: Requires the audit committee to report it's recommended choice for external auditor directly to shareholders.</p> <p>2) <u>Sarbanes-Oxley Act of 2002</u>: The audit committee of the board would be responsible for hiring and firing of auditors.</p> <p><b>Regulatory:</b></p> <p>1) <u>SEC Regulatory Efforts</u>: The audit committee of the board would bear sole responsibility for the hiring and firing of independent auditors.</p> <p>2) <u>NYSE Dropped Proposed Guideline</u>: Grants the audit committee sole authority to hire and fire auditors (this requirement is contained in the Sarbanes-Oxley Act of 2002).</p> <p>3) <u>Proposed NASDAQ Guidelines</u>: The audit committee would have the sole authority to hire and fire the outside auditors and would have to approve, in advance, all services rendered by the auditor that are not related to the audit. A non-independent director could serve on the audit committee in "exceptional and limited circumstances" but only for two years and could not serve as chair of the committee.</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Director Independence/Disclosure</b>					
2) Audit Committee Authority/Responsibility (Cont.)				CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.	
3) Audit Committee Qualifications	Amend Financial Responsibility Criteria for Corporate Investments by revising Section A, 'Auditors', to include subsection 2: "All members of the Audit Committee will be persons whose past/current employment experience/education demonstrates expertise in finance and/or accounting, including being or having been a CEO or other senior executive officer with financial oversight responsibilities. The Board of Directors shall provide a written and signed statement in the annual report/proxy statement, attesting that it has determined that the members of the Audit Committee have the expertise in finance and/or accounting necessary for the execution of its oversight and monitoring duties. The Board of Directors shall attest in this statement, that the Audit Committee members can read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement. The Board of Directors shall assess the adequacy of the Audit Committee on an annual basis. This report should have the same protections offered by the SEC in its "safe harbor" for the existing Executive Compensation report included in the proxy statement."	<p>Proactive communication of CalSTRS' views on importance of Audit Committee qualifications</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	<p>CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII</p> <p>Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration</p>	<p>Guidelines amended on 04/03/02; 1,583 "no" votes cast by CalSTRS on ratification of auditors as of FY '02</p> <p>Letters sent to oversight bodies on 04/30/02</p> <p>Letters sent to: SEC, NYSE, NACD, NASD through 07/02.</p> <p>CEO gave speech to California Chamber of Commerce on 04/16/02--matrix highlighted</p> <p>Institutional investors being contacted. Meeting with CalPERS scheduled for 04/29/02</p> <p>Contacted State of Florida, NYCERS, NY State, TIAA CREF, State of Pennsylvania</p> <p>CalSTRS issued press release; CII highlighted Subcommittee agenda item in April 18th Newsletter</p> <p>(Continued on next page)</p>	<p><b>Federal:</b> 1) <u>Sarbanes-Oxley Act of 2002:</u> Requires the SEC issue rules requiring the company to disclose whether the committee contains at least one member who is a "financial expert," and if not, why not.</p> <p><b>Regulatory:</b> 1) <u>Proposed NYSE Guidelines:</u> Requires that the chair of the audit committee have accounting or financial management experience.</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Director Independence/Disclosure</b>					
3) Audit Committee Qualifications (Cont.)				CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.	
4) Executive Compensation	Research and recommend standards for better disclosure	Proactive communication of CalSTRS' views on the importance of plain language descriptions and heightened disclosure	CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration	Research in progress.  Loans to executives prohibited in Sarbanes-Oxley. This practice is consistent with CalSTRS guidelines on executive compensation.	<b>Federal:</b> <u>Senate Finance Committee Pension Legislation: Requires the removal of a 1978 moratorium on new regulations regarding executive deferred compensation arrangements, and permits Treasury to better define deferred compensation arrangements that merit deferral of taxation and those that should be taxed currently.</u>  <u>Provides that funds in an offshore trust will be deemed not to be subject to the claims of creditors, and generally the funds will be taxed.</u>  <u>Would clarify that a payment would be considered as compensation rather than a loan unless the arrangement met minimum standards (written debt instrument, established repayment periods, and adequate security). In addition, loans above \$1 million would be required to have an interest rate equal to 3% points higher than the applicable government published rate.</u>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>External Auditor Independence and Disclosure</b>					
1) Limitations on Non-Audit Services	Amend the Financial Responsibility Criteria for Corporate Investments, Section A, 'Auditors', to include subheading 3 to read: "CalSTRS supports the limitation of non-audit services that an external auditor can provide to an audit client. If non-audit services other than taxation issues are provided and disclosed, CalSTRS may cast a negative vote against that auditor's continuance. External auditors that also have direct investments in audit clients or affiliates of audit clients will not be considered as Independent Auditors/Accountants and CalSTRS shall cast a negative vote against the auditor's selection/adoption."	<p>Proactive campaign to prohibit/restrict non-audit services to anything other than taxation issues</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p> <p>Send letters of support to Senator Sarbanes</p>	<p>CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII</p> <p>Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration</p>	<p>Guidelines amended on 04/03/02; 1,583 "no" votes cast by CalSTRS on ratification of auditors as of FY '02</p> <p>Letters sent to oversight bodies on 04/30/02</p> <p>Letters sent to: SEC, NYSE, NACD, NASD through 07/02</p> <p>CEO gave speech to California Chamber of Commerce on 04/16/02-matrix highlighted</p> <p>Institutional investors being contacted. Meeting with CalPERS scheduled for 04/29/02</p> <p>Contacted State of Florida, NYCERS, NY State, TIAA CREF, State of Pennsylvania</p> <p>CalSTRS issued press release; CII highlighted Subcommittee agenda item in April 18th Newsletter</p> <p>(Continued on next page)</p>	<p><b>Federal:</b></p> <p>1) <u>S. 2004 (Dodd-Corzine)</u>: Prohibits firms from providing audit and non-auditing services simultaneously, but tax consulting is permitted if approved in advance by the audit committee.</p> <p>2) <u>Administration Proposal</u>: Directs the SEC to establish guidelines to prohibit performance of non-audit service if it compromises the independence of the audit.</p> <p>3) <u>S. 2460 (Levin)</u>: Increases auditor independence by barring an audit firm from auditing its own work and from providing non-auditing services to a company during the course of its audit contract and for two years afterward.</p> <p>(Continued on next page)</p>



CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
External Auditor Independence and Disclosure					
1) Limitations on Non-Audit Services (Continued)				<p>CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.</p> <p>Letter supporting auditor independence and accounting oversight sent to Senator Sarbanes 4/25/02 and 6/17/02</p> <p>CalSTRS policy limits firms to 7 consecutive years; legislation targets audit partners - see "Comments" box</p> <p>Public Company Accounting Oversight Board (PCAOB) created 07/02 audit firms cannot provide non-audit services to audit clients.</p>	<p>5) Sarbanes-Oxley Act of 2002: Bars auditing firms from providing certain non-auditing services to audit clients. All other non-audit work, including tax services, not specifically barred in the statute is allowed if pre-approved by a public company's audit committee</p> <p><b>State:</b> 1) SB 1527 (Burton): Failed passage by Legislature</p> <p><b>Regulatory:</b> 1) SEC Regulatory Efforts: The audit committee of the board would bear sole responsibility for approving in advance the provision of non-auditing services to the company by the independent auditor. 2) NYSE Dropped Proposed Guidelines: Grants the audit committee sole authority to approve any significant non-audit work by the auditors (this requirement is contained in the Sarbanes-Oxley Act of 2002).</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>External Auditor Independence and Disclosure</b>					
2) Rotation of External Audit Firm, Limit Term to 7 Consecutive Years	Amend the Financial Responsibility Criteria for Corporate Investments, Section A, 'Auditors', to include subheading 4 to read: "CalSTRS supports limiting external auditor firms to seven consecutive years of audit service to portfolio companies."	<p>Proactive communication of CalSTRS policy of seven-year rotation of external audit firms</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	<p>CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII</p> <p>Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration</p>	<p>Guidelines amended on 04/03/02; 1,583 "no" votes cast by CalSTRS on ratification of auditors as of FY '02</p> <p>Letters sent to oversight bodies on 04/30/02</p> <p>Letters sent to: SEC, NYSE, NACD, NASD through 07/02.</p> <p>CEO gave speech to California Chamber of Commerce on 04/16/02-matrix highlighted</p> <p>Institutional investors being contacted. Meeting with CalPERS scheduled for 04/29/02</p> <p>Contacted State of Florida, NYCERS, NY State, TIAA CREF, State of Pennsylvania</p> <p>CalSTRS issued press release; CII highlighted Subcommittee agenda item in April 18th Newsletter</p> <p>(Continued on next page)</p>	<p><b>Federal:</b></p> <p>1) <u>S. 2004 (Dodd-Corzine)</u>: Requires the SEC to review effects of mandatory rotation of accounting firms.</p> <p>2) <u>Sarbanes-Oxley Act of 2002</u>: Rotation of outside audit firms is not required. Instead, audit partners are prohibited from working on audits of the same corporate client for more than five years.</p>

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External Auditor Independence and Disclosure					
2) Rotation of External Audit Firm, Limit Term to 7 Consecutive Years (Cont.)	CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.			CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.  Letter supporting auditor independence and accounting oversight sent to Senator Sarbanes 4/25/02.	

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>External Auditor Independence and Disclosure</b>					
3) Cooling-Off Period Regarding Employment with Client	Amend the Financial Responsibility Criteria for Corporate Investments, Section A, 'Auditors', to include subheading 5 to read: "CalSTRS supports a one year cooling-off period regarding the employment, as either Staff or a Member of the Board of Directors, of persons on the companies' external audit team or senior management of the external audit firm."	<p>Proactive campaign to prohibit employment by external auditor team personnel or external audit firm control persons with client for one year, in either staff or board role.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	<p>CalSTRS CalPERS NASD NYSE SEC NACD AICPA CII Nat'l Legislatures/ Regulatory/ State Regulatory/ Legislative bodies Administration</p>	<p>Guidelines amended on 04/03/02; 1,583 "no" votes cast by CalSTRS on ratification of auditors</p> <p>Letters sent to oversight bodies on 04/30/02</p> <p>CEO gave speech to California Chamber of Commerce on 04/16/02- matrix highlighted</p> <p>Institutional investors being contacted. Meeting with CalPERS scheduled for 04/29/02</p> <p>CalSTRS issued press release; CII highlighted Subcommittee agenda item in April 18th Newsletter</p> <p>CEO certification of Russell 1000 companies required on 8/14/02; 85% complied. Criteria included \$1.2 B revenue for FY; bankruptcies, extensions, reduced the number.</p> <p>Letter supporting auditor independence and accounting oversight sent to Senator Sarbanes 04/25/02</p>	<p><b>Federal:</b></p> <p>1) <u>S.2004 (Dodd-Corzine)</u>: Requires 2-year cooling-off period for auditor to serve in senior financial position of client.</p> <p>2) <u>S. 2460 (Levin)</u>: Increases auditor independence by barring an audit firm from auditing its own work and from providing non-auditing services to a company during the course of its audit contract and for two years afterward.</p> <p>3) <u>Sarbanes-Oxley Act of 2002</u>: A one-year cooling off period is imposed on a company's hiring of outside auditor personnel as CEO or CFO.</p> <p><b>State:</b></p> <p>1) <u>AB 2970 (Wayne)</u>: Requires 2-year cooling-off period for auditor to accept senior management job with client.</p> <p><b>Regulatory:</b></p> <p>1) <u>Proposed NYSE Guidelines</u>: Tightening the definition of an independent director, including a five-year cooling-off period for former employees.</p> <p>(Continued on next page)</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
External Auditor Independence and Disclosure					
3) Cooling-Off Period Regarding Employment with Client (Cont.)					2) NASDAQ Proposed Guidelines: A three year cooling off period would apply to directors who are not independent due to (i) interlocking compensation committees; (ii) the receipt by the director or a family member of any payments in excess of \$60,000 other than for board service; or (iii) having worked on the company's audit engagement.

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Deferred Compensation - Defined Contribution Plans</b>					
1) Employees will have a choice on whether to invest in a company's defined contribution plan	Support choice on whether to invest in a company's defined contribution plan.	Support selected federal legislation/regulatory/ administration proposal that will codify this choice.	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/ Regulatory/ State Regulatory/ legislative bodies, Administration, Department of Labor, PBGC	<p>Sarbanes-Oxley requires 30 day written notice in advance of black-out periods.</p> <p>Executives not allowed to trade during black-out periods.</p> <p>Fiduciary duty specified for defined contribution plans to be that of E.R.I.S.A.</p>	<b>Federal:</b> 1) <u>S. 1992</u> : Employer requirements that plan assets be invested in employer stock would be barred.
2) Employees will have a choice over the form of employer/company's matching contribution	Support choice over the form of employer/company's matching contribution.	Support selected federal legislation/regulatory/ administration proposals that will codify the choice over the form of employer/ company's matching contribution.	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/ Regulatory/ State Regulatory/ legislative bodies, Administration, Department of Labor, PBGC	<p>Sarbanes-Oxley requires 30 day written notice in advance of black-out periods.</p> <p>Executives not allowed to trade during black-out periods.</p> <p>Fiduciary duty specified for defined contribution plans to be that of E.R.I.S.A.</p>	

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<b>Deferred Compensation - Defined Contribution Plans</b>					
3) Limit employer stock holdings in employee defined contribution plans to 10% or less unless employee requests the company to waive the cap and allow the employee to allocate up to 100% of her defined contribution plan to company stock	Support default cap as long as it allows employee to choose whether to increase investment in company stock	Support selected federal legislation/regulatory/administration proposal to set a default cap (10% or less unless employee requests waiver). Not directly addressed on national level.	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/ State Regulatory/ legislative bodies, Administration, Department of Labor, PBGC	Under consideration	
4) Reduce or eliminate corporate restrictions on employee liquidation of company stock	Support easing of restrictions on employee liquidation of company stock and increased education regarding the provision.	Support the reduction/elimination of restriction on employee liquidation of company stock.	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/ State Regulatory/ legislative bodies, Administration, Department of Labor, PBGC	Under consideration	<b>Federal:</b> 1) <u>H.R. 3669 (Portman-Cardin)</u> : Permits diversification of specified percentage of employer stock in 401(k) plan after 3 yrs of service by employee. 2) <u>H.R. 3762 (Boehner)</u> : Permits employees to diversify out of employer securities after 3 yrs of participation or service. 3) <u>S. 1971 (Grassley)</u> : DC plans invested in publicly-traded employer securities would be required to provide participants with the right to diversify elective deferral amounts immediately and employer contributions invested in employer securities once the participant has 3 or more yrs of service. 4) <u>S. 1992 (Kennedy)</u> : Permits employer stock matches or investment in company stock, but not both, and prohibits required investment of plan assets in company stock. 5) <u>Administration Proposal</u> : Employees would be permitted to sell company stock and diversify into other investment options after they have participated in the employer's section 401(k) plan for at least 3 yrs. (Continued on next page)

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
Deferred Compensation - Defined Contribution Plans					
4) Reduce or eliminate corporate restrictions on employee liquidation of company stock (cont.)					<div>6) Senate Finance Committee Pension Legislation: Requires that publicly held companies must allow workers to divest themselves of company stock once they have completed 3 years of service (with a 3 year phase-in for stock contributed in previous years). Only free-standing ESOPs are exempt from the requirement.</div> <div>Would permit immediate divestiture for employees who are nearing retirement (age 55 or older).</div>



CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
Deferred Compensation - Defined Contribution Plans					
5) No record keeper transition/change or resulting blackout period if company stock has declined 30% over the previous 60 days. In addition, companies/ employers should give 30 days notice prior to any record keeper transition/ change	Support the restriction of record keeper changes and any resulting blackout period if company stock has declined 30% or more over the previous 60 days. Support efforts to reduce length of any blackout period. Employees should also receive increased education about this provision.	Support record keeper transition restrictions. Not currently addressed on the national level.	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/ Regulatory/ State Regulatory/ legislative bodies, Administration, Department of Labor, PBGC		<b>Federal:</b> 1) <u>H.R. 3669 (Portman-Cardin)</u> : Requires 30 day notice of blackout. 2) <u>H.R. 3762 (Boehner)</u> : Requires 30 day notice if the blackout is more than 3 consecutive days. 3) <u>S. 1971 (Grassley)</u> : DC plan participants would have to receive at least 30 days notice of any impending "lock-down" 4) <u>S. 1992 (Kennedy)</u> : Requires 30 day notice before blackout, and blackout length may not be unreasonable. 5) <u>Administration proposal</u> : Requires 30 day notice of blackout. 6) <u>Sarbanes-Oxley Act of 2002</u> : <u>Requires 30-day notice prior to a blackout period.</u>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
Deferred Compensation - Defined Contribution Plans					
6) Support, in concept, selected legislative efforts to protect retirement security	Support selected legislative efforts to protect retirement security that address issues presented here.	Support selected legislative efforts to protect retirement security.	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration, Department of Labor, PBGC		<p><b>Federal:</b></p> <p>1) <u>Sarbanes-Oxley Act of 2002: Specifies fiduciary duty of defined contribution plans to be consistent with ERISA.</u></p> <p>2) <u>Senate Finance Committee Pension Legislation: Requires sponsors of defined contribution plans under a new ERISA provision to ensure that all material information the employer is required to disclose to investors under the securities laws also be provided to workers concerning investments in company stock in the worker's account.</u></p> <p><u>Requires quarterly benefit statements for defined contribution plans that allow workers to direct their own investments; annual statements for plans that do not allow worker investment direction; and once every 3 years to workers in defined benefit plans.</u></p> <p><u>Requires that companies sponsoring plans that allow workers to invest in employer stock disclose to plan participants any sale of stock by an officer, director, or affiliate or the employer is required to be disclosed to the SEC.</u></p> <p>(Continued on next page)</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
Deferred Compensation - Defined Contribution Plans					
6) Support, in concept, selected legislative efforts to protect retirement security (cont.)					<p>The information must be posted on the plan's website in a reasonably practicable timeframe after disclosure to the SEC.</p> <p>Would clarify the individual's right to sue a fiduciary under ERISA.</p> <p>Increases the bond cap for fiduciaries to \$1 million for plans containing employer stock.</p> <p>Requires the Treasury to complete regulations within 30 days of the bill's enactment (regulations would specify the types of information that must be made available to workers before they choose a form of benefit).</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Accounting Standards</b>					
1) Reform/review the Accounting Standards, especially regarding new/complex financial transactions (Special Purpose Entities or SPEs)	Support the reform/review of accounting industry standards and accounting standards, generally. Independent industry accounting standards and transaction accounting standards are prophylactic for all investors. Independent auditors should not be advocates for audit clients; unlike other service vendors who must satisfy the client to make a sale, independent auditors occupy a unique position in our capital markets and hold a public trust. Audit work should be priced fairly, not at marginal rates, in the hopes of securing management advisory services at more profitable levels.	<p>Support CII policy and legislative/regulatory/ administrative proposals that accounting standards be updated. Seek buy-in of institutional users of financial statements, such as SEC, NYSE, NASD, investment analysts, investment managers, banks, underwriters.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p> <p>Send letter of support to Senator Feinstein</p> <p>Send letter of support to Senator Leahy</p>	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/ Regulatory/ State Regulatory/ legislative bodies, Administration	<p>CII policy regarding auditor independence supported at most recent CII meeting, March 25, 2002.</p> <p>Institutional investors being contacted; also outreach to users of financial statements.</p> <p>Letters to oversight bodies sent on 4/30/02.</p> <p>Letter sent to Senator Feinstein 4/30/02</p> <p>Letter sent to Senator Leahy on 4/26/02</p>	<p><b>Federal:</b></p> <p>1) Sarbanes-Oxley Act of 2002: Directs the SEC to complete a study of off-balance sheet transactions and the use of special purpose entities, and to make recommendations regarding the future treatment of such transactions and entities.</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Accounting Standards</b>					
2) Improve Accounting Industry Oversight/Regulatory and Enforcement Powers	Support the improvement of independent oversight of the accounting industry by the Securities and Exchange Commission.	<p>Support greater oversight by the SEC. Current proposals want the private sector to pay for an oversight arm of the SEC, but want the agency to be independent of the accounting profession/industry; may not be possible. All proposals would give the oversight body subpoena and disciplinary power. Currently being reviewed legislatively.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p> <p>Send Letters of support to House-Senate Conferees</p>	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration	<p>Letter sent to SEC on 4/30/02. Senator Sarbanes letter also references this issue.</p> <p>Institutional investors being contacted; also outreach to users of financial statements.</p> <p>Letters to oversight bodies sent on 4/30/02.</p> <p>Letters sent to House-Senate Conferees on 7/18/02.</p> <p>CIO appeared on Bloomberg Financial News 7/02.</p>	<p><b>Federal:</b></p> <p>1) <u>S. 2004 (Dodd-Corzine)</u>: Establishes five-member Independent Public Accounting Board (with 3 public members) within the SEC to assess compliance with securities law and standards of ethics and impose sanctions for violations of those laws and standards.</p> <p>2) <u>Administration proposal</u>: Establishes an independent regulatory board under the SEC's supervision to develop standards of professional conduct and would monitor and enforce ethics principles.</p> <p>(Continued on next page)</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
Accounting Standards					
2) Improve Accounting Industry Oversight/Regulatory and Enforcement Powers (Cont.)					<p>3) Sarbanes-Oxley Act of 2002: Establishes a 5 member auditor oversight board appointed by the SEC. The board would be independent of the accounting industry in the sense of the appointment of its members and the fact that no more than two members can have ties to the accounting industry.</p> <p><b>Regulatory:</b></p> <p>1) SEC Regulatory Efforts: A Public Accountability Board would set or oversee the establishment of professional audit, quality control, and ethics standards. A board will have 6 public members and 3 members of the accounting profession.</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Accounting Standards</b>					
3) Increased disclosure standards of auditor services/revenues	Support the increased disclosure standards relative to non-audit services. We will actively support the prohibition against all non-audit services, but without a prohibition, disclosure is a necessity for investors.	<p>Support CII, SEC, as well as other institutional investors efforts regarding the increased disclosure of auditor ties.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	<p>CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration</p>	<p>Letter sent to SEC on 4/30/02. Senator Sarbanes letter also references this issue.</p> <p>Institutional investors being contacted; also outreach to users of financial statements.</p> <p>Letters to oversight bodies sent on 4/30/02.</p>	<p><b>Federal:</b></p> <p>1) Sarbanes-Oxley Act of 2002: Directs the SEC to adopt final rules within 180 days requiring disclosure of all material off-balance sheet transactions, arrangements, obligations and relationships, including those with unconsolidated entities.</p>
4) Increase mandatory liability limits for external auditor firms	Support the increase of liability limits for external auditor firms, although it is recognized that an independent auditor's report is no guarantee that a company will prosper.	<p>Support increased liability limits for external auditor firms. Not addressed by others yet; seek buy-in from other investors, as well as SEC, appropriate legislative/ regulatory parties.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	<p>CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration</p>	<p>PCAOB will determine this issue once established.</p>	

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>Accounting Standards</b>					
5) Broader disclosure of client company's entrance into forward equity contracts	Support increased disclosure and information regarding companies' risk with respect to forward equity contracts as it relates to the underlying capital structure	<p>Support broader disclosure regarding risk of company's entry into forward equity contracts. Seems to be addressed in the accounting standards, may need more flexible language. Not addressed by others yet. Further research is needed.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration	Research in progress	<p><b>Federal:</b>  <u>Senate Finance Committee Pension Legislation: Requires that the chief executive officer of a corporation must sign the corporation's federal income tax returns under penalties of perjury.</u></p>



CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>General Governance</b>					
1) Develop general guidelines for a governance system	Support the active dissemination of general governance guidelines and a best practices of corporate governance	<p>Enhance director independence standards; board committee standards. Require all review committees to be comprised entirely of independent directors.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration	<p>Sent copies of CalSTRS guidelines to NACD, CII, and AICPA.</p> <p>Met with workplan companies on governance matters.</p> <p>Adopted Investor Protection Principles as part of CalSTRS guidelines.</p>	<p><b>Federal:</b></p> <p>1) Sarbanes-Oxley Act of 2002: Requires SEC to review current corporate governance standards and practices to determine whether such standards and practices are serving the best interests of shareholders and report findings in the next annual report.</p> <p>2) S. 2004 (Dodd-Corzine): Requires exchanges to review current corporate governance standards and practices to determine whether such standards and practices are serving the best interests of shareholders and report findings within 90 days.</p>
2) Establish minimum corporate governance standards	Addressed above	<p>Eliminate broker voting; support CII, CalPERS efforts on this. Seek buy-in of others in the proxy process, especially corporations.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration	Met with investment managers to discuss Investor Protection Principles: BGI, BatteryMarch, Delphi, Lazard Freres, Marvin & Palmer, Putnam, SSgA	<p><b>Regulatory:</b></p> <p>1) <u>Proposed NYSE Guidelines:</u> Mandating that listed companies adopt and publish corporate governance guidelines and a code of business conduct and ethics.</p>

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>General Governance</b>					
3) Reform the Private Securities Litigation Reform Act of 1995 (PSLRA)	Support reform of the Private Securities Litigation Reform Act of 1995 as it relates to liability standards for independent auditors.	<p>Support reform of the Private Securities Litigation Reform Act of 1995 with respect to joint and several liability. Seek buy-in of others in the securities litigation area, such as CalPERS and other institutional investors.</p> <p>Send letters to oversight bodies such as NASD, NYSE, SEC, NACD, AICPA, CII</p> <p>Use press, speaking forums</p> <p>Seek buy-in from other institutional investors</p> <p>Testimony</p>	CalSTRS, CalPERS, NASD, NYSE, SEC, NACD, AICPA, CII, Nat'l Legislatures/Regulatory/State Regulatory/legislative bodies, Administration	Research in progress	
4) Adopt Investor Protection Principles	Incorporate into Financial Responsibility Criteria for Corporate Investments.	Disseminate Principles to CalSTRS brokers and investment managers; conduct annual compliance review.	CalSTRS, CalPERS, STO.	Implementation plan has been developed. Initial letters to external relationships will be sent by October 2002.	

CONCERN	CALSTRS' INTERNAL ACTION	CALSTRS' EXTERNAL ACTION	RELEVANT ENTITIES	STATUS	COMMENTS
<b>General Governance</b>					
5) Sworn Statements by CEOs and CFOs	The CEOs and CFOs of 947 public companies were required to file sworn statements with the SEC by August 14, 2002. These statements were to attest to the accuracy of the companies' most recent annual and quarterly financial reports. Investments staff screened the SEC's list against the constituents of the Russell 1000 benchmark.	<p>Send Letters of support to Congressmen Daschle &amp; Lott</p> <p>Send letters of support to Congressmen Royce &amp; Cox</p>	CalSTRS, SEC	<p>553 issues within the Russell 1000 (actually 991 companies) provided certifications to the SEC, 91 did not, and 347 were not required to provide certifications. In percentages, 85.9% of companies required to certify within the Russell 1000 did so. Overall, that is 55.8% of the R1000.</p> <p>Letters sent to Congressmen Daschle &amp; Lott on 7/3/02.</p> <p>Letters sent to Congressmen Royce &amp; Cox on 7/23/02.</p>	<p><b>Federal:</b>  <u>1) Sarbanes-Oxley Act of 2002:</u>  CEO and CFO certifications required for (i) each annual and quarterly report, and (ii) each periodic report containing financial information.</p> <p><b>Regulatory:</b>  <u>1) Proposed NYSE Guidelines:</u> The CEO would be required to certify each year that he or she is not aware of any violations of NYSE listing standards, and this certification would have to be included in the company's annual report.</p>